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Depository Institutions Deregulation and Monetary Control Act of 1980 and its effect on financial markets and institutions

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The Depository Institutions Deregulation and Monetary Control Act of 1980 and Its Effect on Financial Markets and Institutions

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Preface

This paper covers the Depository Institutions Deregulation and Monetary Control Act of 1980 with a broad stroke. Though the Act had more than nine titles, or "sub-acts," they were all related to two areas. These are the focus of the paper: the deregulation of the banking and thrift industry and the revision of laws used to regulate that industry and the economy.

A cause and effect thread is used to track the Act through its inception, enactment, and impact on major financial institutions, markets in general, and individuals. The effects gauged are those of policy and general market behavior. There is no intention to analyze details such as the day to day operating activities of the Federal Open Market Committee.

The research analysis is limited to the period from 1980 to 1984 and is compared to the late 1970's. Beyond 1984, the Garn-St. Germain Depository Institutions Act of 1982, distorted the effects of the 1980 act, and low inflation reduced its impact.

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THE ACT ITSELF

The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) has its roots in two areas: the high inflation of the late 1970's and the inequities built into law that prevented banks and thrifts from competing in such an environment.

As early as 1964, the Federal Reserve noted that such inequities existed within the its system.

> The interests of equity and efficiency would be best served if all commercial banks were obligated to observe the same reserve standards and if, at the same time, such banks were afforded access to the Federal Reserve Bank discount window.[1]

At the time, non-member banks did not have to maintain reserves with the Federal Reserve.

When inflation picked up in the late 1960's it hurt the earnings of depository institutions as deposits were siphoned off to instruments paying unregulated and higher interest rates. In response President Nixon set up the Hunt Commission to study the situation. The commission's 1971

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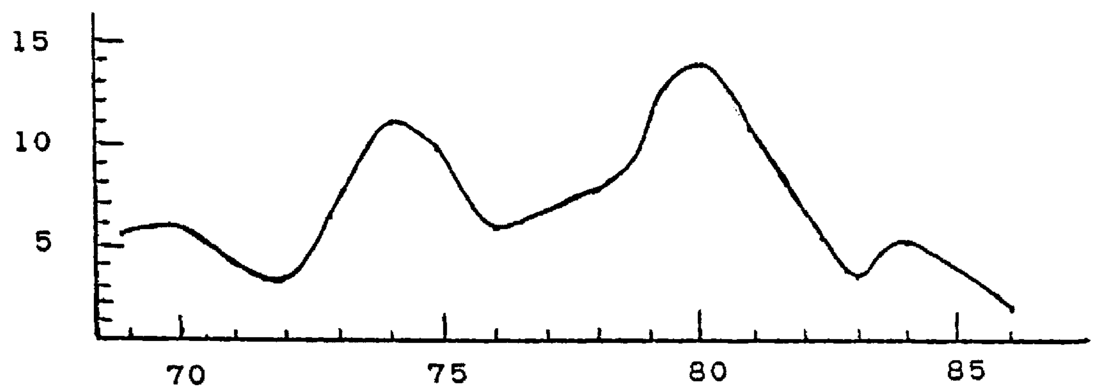
[1]Charles R. McNeil, "The Depository Institutions Deregulation and Monetary Control Act of 1980," The Federal Reserve Bulletin, 66, (June 1980), p. 444.

report recommended removing interest rate ceilings paid on deposits and allowing thrifts greater latitude in the loans they were allowed to offer. The Senate Financial Institutions and Nations Economy Study echoed those recommendations as inflation once again picked up in the mid-1970's.[a]

Figure 1

INFLATION RATE



Sources: Statistical Abstract of the U.S., 1976, (Washington, D.C., U.S. Bureau of the Census, 1975), p. 433., Statistical Abstract of the U.S., 1988, (Washington, D.C., Bureau of the Census, 1987) p. 450.

It was this inflation, as shown in figure 1, that squeezed bank and thrift earnings. Table 1 shows the decline of Federal Reserve membership as banks left the system in an effort to cut costs. In many cases cost-cutting was

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[a]Peter S. Rose and Donald R. Fraser, Financial Institutions, (Plano, Texas, Business Publications Inc., 1985), p. 671.

Table 1

RESERVE BANK MEMBERSHIP

Year	77	78	79	80	81	82	83	84
Members	5669	5564	5425	5422	5474	5619	5807	5961

Sources: Statistical Abstract of the U.S., 1982-83, (Washington, D.C., U.S. Bureau of the Census, 1982), p. 503., Statistical Abstract of the U.S., 1988,(Washington, D.C., U.S. Bureau of the Census, 1987), p. 471.

ineffective, as bank and thrift failures increased. These pressures brought Congress to pass DIDMCA in 1980. Federal Reserve membership subsequently recovered.

Legislative action started in 1975 as the Senate passed the Financial Institutions Act. This Act called for broadened investment powers and the removal of interest rate ceilings. At the same time, the House of Representatives was considering a similar bill. It was eventually split into three parts, none of which passed the House.

Not until 1978, with Federal Reserve membership still declining, were elements of what was to become DIDMCA again seriously considered by Congress. This was done in a piecemeal fashion. In June, the House Banking Committee approved a bill to allow federally chartered savings and loans to offer checking accounts where state chartered thrifts were offering such accounts.

In July, 1978, the House panel took up the problem of reserve membership. Because reserve requirements applied only to Federal Reserve members, institutions were dropping their membership in order to cut costs. The original bill, as proposed by Rep. William Stanton (R., Ohio), would have weakened the Federal Reserves' abilities. It would have tied the discount rate to Treasury securities, set reserve requirements by law and made the Federal Reserve pay interest on the reserves it held.[3]

Federal Reserve Chairman William Miller opposed these actions in a letter to the House panel and in testimony before the Senate Banking Committee. He argued that not only would it not stop the exodus but that it would severely hamper the Federal Reserves' effectiveness. The Senate was considering requiring all financial institutions to place reserves with the Federal Reserve and having the Federal Reserve pay interest.[4]

There was no doubt that something needed to be done. In the previous eight years, 430 banks had left the Federal Reserve while only 103 had joined and the exodus was accelerating.[5]

In September of 1978 the House Banking Committee approved in principal, but did not pass, a bill in line with Chairman Miller's views. This bill became the basis for the monetary control portion of DIDMCA. It required all depository

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[3]Greg Conderacci, "Anti-Fed Action Backed By Some On House Panel," The Wall Street Journal, (July 17, 1978), p. 4.

[4]"Miller Says Erosion of Bank Membership Is Hurting Fed Goals," The Wall Street Journal, (Aug. 15, 1978), p. 2.

[5]Ibid., p. 2.

institutions to maintain reserves as determined by the Federal Reserve but within a range set by law. The reserves applied to checking and savings accounts as well as time deposits. The first $50 million in checking and savings deposits was exempt as well as the first $50 million in time deposits. Though this was intended to give smaller institutions a chance to compete, it effectively left 90 percent of commercial banks with no reserve requirements.

Three other provisions of this bill were included in DIDMCA. It allowed all federally insured institutions access to the Federal Reserves' discount window and required the Federal Reserve to charge for services. It also required all institutions to report deposits to the Federal Reserve. Previously, only Federal Reserve members had to report.

The bill did not include provisions calling for the discount rate to be tied to Treasury securities, nor did it call for the Federal Reserve to pay interest on reserves.[6] It was not until mid-1979 that the bill passed the entire House.

Action on a similar bill was postponed by the Senate Banking Committee until 1979 due to opposition from the 225 non-member banks that would be required to institute reserves and the American Bankers Association.

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[6] "House Banking Panel Approves Bill On Reserves," The Wall Street Journal, (Sep. 13, 1978), p. 2.

In April, 1979, a court ruling brought banking practices into play. Federal regulators had been allowing banks to have automatic transfers from savings to checking accounts, savings and loans to operate automatic tellers in different locations, and credit unions members to write "share drafts," or checks. The American Bankers Association brought suit against the National Credit Union Association. The Independent Bankers association brought suit against the Federal Home Loan Bank Board. And, the U.S. League of Savings Associations brought suit against the FDIC and the Federal Reserve. All claimants stated that unfair practices were taking place to circumvent regulations. A federal appeals court in Washington, D.C., agreed with all three plaintiffs in one ruling. The court ruled that only the Congress could allow such activities and that the regulators had overstepped their authority.

However, the court also ruled that because it would cause a financial strain to shut down these operations immediately, its desist order would not take affect until January 1, 1980. In essence, the court was giving Congress time to make rules on these matters.

In June, 1979, the House Banking Committee finally passed the bill to help stop banks from leaving the Federal Reserve system. The bill was essentially the same as that approved in principal in 1978. The differences were in the reserve requirements. Reserves were only required on transaction deposits above $35 million and short term commercial time deposits above $10 million. Unlike the earlier bill there were no reserve requirements on savings, personal time deposits, or commercial long term deposits. The net effect would be that only 1,000 institutions would be required to have reserves compared with the 5,500 holding reserves in June 1979. Of the 1,000 institutions, 700 were existing Federal Reserve members.[7] In July this measure passed the entire House.

In early September, The House Banking Committee passed a bill to deal with the earlier court ruling. In each case, automatic transfers, automatic tellers, and "share drafts," the bill allowed the activities to continue. The committee also tacked on a provision to allow negotiated order withdrawal (NOW) accounts at thrifts and banks nationwide. These accounts were previously only available in New England.

Also, in September, the Senate took up two bills similar to those passed in the House. The bill to stop banks from leaving the Federal Reserve had a new twist. It would require reserves only on transaction accounts at all federally insured institutions, but only if the Federal Reserves' coverage of the nation's deposit base fell to 67.5

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[7] "Measure To Stem Exodus of Banks From Fed Gains," The Wall Street Journal, (June 6, 1979), p. 4.

percent. In September, that coverage stood at 72 percent.[8] This bill never passed the entire Senate.

The Senate Banking Committee also considered a bill to cover the earlier court ruling. It was essentially the same as the House version with one exception. The committee added a provision to eliminate Regulation Q interest rate ceilings. The ceilings would be phased out over a ten year period beginning in two years. In 1979, banks were limited to paying 5 and 1/4 percent interest on savings and thrifts were limited to 5 and 1/2 percent.

By the time this bill passed the Senate floor it contained two additional provisions. One would temporarily suspend state imposed interest rate ceilings on business and agriculture loans. The other placed a moratorium on foreign takeover of domestic banks.

As Congress' 1979 session came to a close the full House had passed a bill on Federal Reserve membership, but the Senate had not. And the full Senate had passed a bill based on the court cases, NOW accounts, and Regulation Q, but the House had not. Before they recessed for the holidays, the Congress was able to pass stopgap measures that would let the bank and thrift industry operate as before. It allowed draft shares, automatic transfers, and automatic tellers to continue until March 31, 1980. It also extended existing

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[8]Edward F. Smith, "Bills Move As Banks Watch Volcker," ABA Banking Journal, 71, (Sep. 1979), p. 5.

Regulation Q ceilings, which were due to expire at the end of 1979, until March 31. It was hoped that both houses could come up with a compromise bill by that time.

As the 1980 session opened, Senate Banking Committee Chairman William Proxmire (D., Wis.) said that they would not take up the House passed bill until the House took up the Senate passed bill. Representative Henry Reuss (D., Wis.) of the House Banking Committee said that the House would not take up the Senate passed bill until the Senate took up the House passed bill.[9] But lobby efforts and the growing crisis eventually brought the two together.

Big banks were enthusiastic about raising interest rates ceilings because it would stop the money flowing to money market mutual funds. Small banks and thrifts were worried that they could not afford the high rates. The thrifts were worried that they would be especially hard hit as their portfolios contained many low yielding mortgages.

The Federal Reserve stated that it believed paying interest on reserves would stop banks from leaving the Reserve system but it did not want to lose the authority to alter reserve requirements and discount rates. Most in Congress believed that paying interest on reserves would put an unnecessary strain on the national budget.

Federal Reserve policies implemented in October 1979 had

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[9]Christopher Conte, "Congress Tackles Controversial Bank Legislation Again," The Wall Street Journal, (Jan. 23, 1980), p. 3.

caused interest rates to escalate further reducing the earnings of financial institutions. In January, the House began considering lifting Regulation Q ceilings with a complete phase out by the end of 1985.

New Federal Reserve Chairman Paul Volcker continued to urge Congress to pass legislation on Federal Reserve membership. In the 13 months covering January, 1979, to January, 1980, 69 banks with $7 billion in deposits had given notice that they would leave the Reserve system. (Another 670 banks were considering leaving.) By February, 1980, the percentage of deposits covered by the Reserve system had dropped to 70 percent.[10]

Also in February, the Carter Administration began to push for legislation. Former Federal Reserve Chairman, now Treasury Secretary, William Miller endorsed the plan to reduce reserve requirements but require all institutions to hold reserves without receiving interest payments.

Federal regulators then endorsed a five year phase out plan for Regulation Q interest rate ceilings. They stated that high inflation and high real interest rates were severely hurting depository institutions. Ten years was too long to wait for phase out while five years gave them enough flexibility to deal with any problems that might come up.

In early March, with their deadline approaching and no new bills passed by either house, House and Senate conferees got

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[10] Ibid., p. 3.

together to hammer out a bill acceptable to both houses. The final bill combined the different bills passed by the House and Senate. It also included other proposals that were not included in bills passed by either house. It was signed into law by President Carter on March 31, 1980. The 61 page document is summarized below.[11]

Title I - Monetary Control Act

- Required reserves on all transaction accounts at all depository institutions eligible for federal insurance. Three percent required for the first $25 million and between 8 and 14 percent required for deposits above $25 million. Though the Federal Reserve was free to vary reserve requirements for deposits above $25 million between these ranges, the reserve requirement was initially set at 12 percent. The Federal Reserve could also adjust the $25 million base to reflect changes in total transaction deposits.

- Required an initial reserve requirement on all non-personal time deposits, at all depository institutions eligible for federal insurance, of three percent while allowing the Federal Reserve to adjust the rate from zero to nine percent.

- Phased in new reserve requirements over four years for current Federal Reserve members and eight years for non-members.

- Allowed Federal Reserve to impose a supplemental reserve requirement of up to four percent in extraordinary situations for a period of up to 180 days. It would be required to pay interest on the supplemental reserves.

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[11]Summary extracted from: Charles R. McNiel and Denise M. Rechter, "The Depository Institutions Deregulation and Monetary Control Act of 1980," Federal Reserve Bulletin, 6, June 1980, pp. 444-453., Digest of General Public Bills and Resolutions, 96th Congress, 2nd Session, (Washington, D.C., Library of Congress, 1981), pp. 104-106., Congressional Quarterly Almanac, 96th Congress, 2nd Session, (Washington, D.C., Congressional Quarterly Inc., 1981), pp. 275-277.

- Extended reserve requirements to U.S. deposits of foreign banks operating in the U.S.

- Instructed the Federal Reserve to charge for its services.

- Entitled all depository institutions maintaining reserves to have access to the Federal Reserves' discount window.

- Authorized Federal Reserve to buy and sell obligations guaranteed by foreign governments.

- Required all depository institutions to report deposits to the Federal Reserve as it determines.

Title II - Depository Institutions Deregulation Act

- Instituted the Depository Institutions Deregulation Committee (DIDC) made up of the heads of the Federal Reserve, the FDIC, the Federal Home Loan Bank Board, the National Credit Union Association, and the Secretary of the Treasury. In addition the Comptroller of the Currency would participate as a non-voting member.

- Directed the DIDC to phase out the Regulation Q interest rate ceilings by March 31, 1986.

- Gave the DIDC authority to approve new types of accounts.

Title III - Consumer Checking Account Equity Act

- Permitted federally insured institutions to offer NOW accounts.

- Permitted all commercial banks to offer automatic transfer of funds.

- Permitted federally chartered savings and loans to operate remote automatic teller machines.

- Permitted federally insured credit unions to offer share drafts.

- Revised upward the amount of federal insurance on deposits from $40,000 to $100,000.

Title IV - Powers of Thrift Institutions

- Permitted federally chartered savings and loans to invest up to 20 percent of their assets in consumer loans, commercial paper, or corporate debt.

- Permitted federal savings and loans to make real estate loans to the same extent as federal banks with no geographic restrictions.

- Replaced $75,000 limit on federal saving and loan mortgages with limit based on the appraised value of the property: 66 and 2/3 percent on unimproved property, 75 percent on property under improvement, 90 percent on improved property, and more than 90 percent in special circumstances such as low income housing.

- Allowed savings and loans to invest in money markets and issue credit cards.

- Permitted federal mutual savings banks to invest up to five percent of assets in commercial loans made within the bank's state or within 75 miles of the home office.

- Permitted credit unions to offer mortgages on cooperative housing.

- Permitted credit unions to raise lending rates to 15 percent and authorized the NCUA to allow higher rates when the situation dictated.

Title V - State Usury Laws

- Permanently pre-empted state usury ceilings on mortgage loans unless overridden by a state within three years.

- Pre-empted for three years only state usury ceilings on business and agricultural loans above $25,000 unless overridden by a state.

- Established interest rate ceilings on all state chartered, federally insured institutions of one percent more than the discount rate on all loans unless overridden by the state.

- Permanently disallowed any state imposed ceilings in interest rates paid on deposits.

Title VI - Truth In Lending Simplification and Reform Act

- Required simple English to be used in disclosure statements.

- Directed the Federal Reserve to produce model forms for disclosure statements.

Title VII - Amendments to National Banking Laws

- Extended the time requirement for national banks and bank holding companies to dispose of impermissible land holdings.

- Permitted the Comptroller, upon Federal Reserve request, to inspect foreign operations of domestic banks.

- Disallowed any new acquisitions of trust companies by out of state banks until October 1, 1981, unless permitted by the state of the acquired trust. Includes trust in the definition of a bank.

- Permitted Comptroller to shut down a bank if its practices are judged unsound.

Title VIII - Financial Regulation Simplification Act

- Directed federal regulators to review their regulations to insure they are needed, clear, concise, and do not overlap or conflict with those of another agency.

Title IX - Foreign Control Of U.S. Financial Institutions

- Disallowed, until July 1, 1980, the foreign acquisition of more than five percent of any domestic depository institution except under special circumstances.

Chapter II

THE INSTITUTIONS

Much of DIDMCA was effective immediately. This included those measures that could bring immediate, though temporary, relief without disrupting markets such as state usury rules and anti-takeover rules and the permanent non-disruptive portions such as raising insurance coverage. It also included the legalization of previously "illegal acts" such as share drafts and automatic tellers.

The sections that took time to implement were those that would have a major impact on institutions and the economy. Regulations had to be written by the Federal Home Loan Bank Board to provide guidance on the expanded investment powers of the savings and loan industry. The Federal Reserve had to determine a price structure for its services and provide guidelines for truth in lending. NOW accounts were delayed so that depository institutions and the Federal Reserve could determine how to cope with the new accounts. All federal regulators had to review their regulations. These areas were all in effect within a year.

The two sections that had the biggest impact took several years to implement. The implementation of new

Table 2

RESERVE REQUIREMENTS

Reserve Requirement Prior to DIDMCA (as % of deposits)	Account Type (millions)	Reserve Requirement After DIDMCA (as % of deposits)
	Demand	
7	0-2	3
9.5	2-10	3
11.75	10-25	3
11.75	25-100	12
12.75	100-400	12
16.25	400 +	12
3	**Savings**	0
	Non-Personal Time	
3	0-5, 30-179 days	3
2.5	180 days-4 yrs.	3
1	4 yrs. +	3
6	5 +, 30-179 days	3
2.5	180 days-4 yrs.	3
1	4 yrs +	3
	Personal Time	
3	0-5, 30-179 days	0
2.5	180 days-4 yrs.	0
1	4 yrs. +	0
6	5 +, 30-179 days	0
2.5	180 days-4 yrs.	0
1	4 yrs.	0

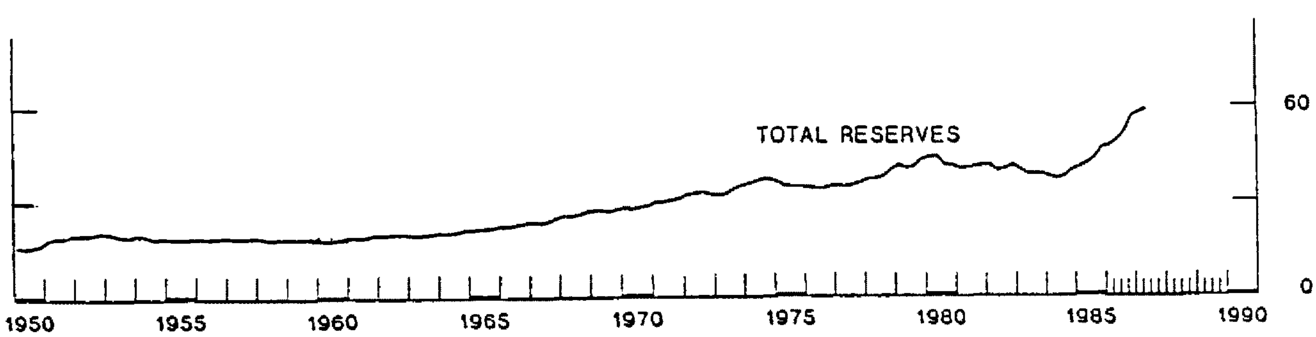
Source: Robert D. Auerbach, Money, Banking, and Financial Markets, (New York, Macmillan Publishing Co., 1982), p. 105.

reserve requirements was phased in over four years for member banks and eight years for non-member institutions. The Federal Reserve set up milestones for institutions to meet in this goal. Those with less reserves than required had to increase them 1/8th or 1/4th of the way to the new requirement each year. New types of accounts, such as the NOW accounts, established after March 31, 1980 were subject immediately to the new reserve requirements. Prior to implementation, Federal Reserve member banks were required to hold the reserves shown in table 2 above.

The new reserve requirements brought about a drop in total reserves held. Figure 2 shows that reserves held did not return to pre-DIDMCA levels until 1985. This undoubtedly played a part in the recovery from the recession of 1982. As the economy and money supply grew, reserves did not keep pace, leaving more money available for expansion.

Figure 2

TOTAL RESERVES HELD
(Billions of dollars)



Source: 1987 Historical Chartbook, (Washington, D.C., Board of Governors of the Federal Reserve System, 1987), p. 2.

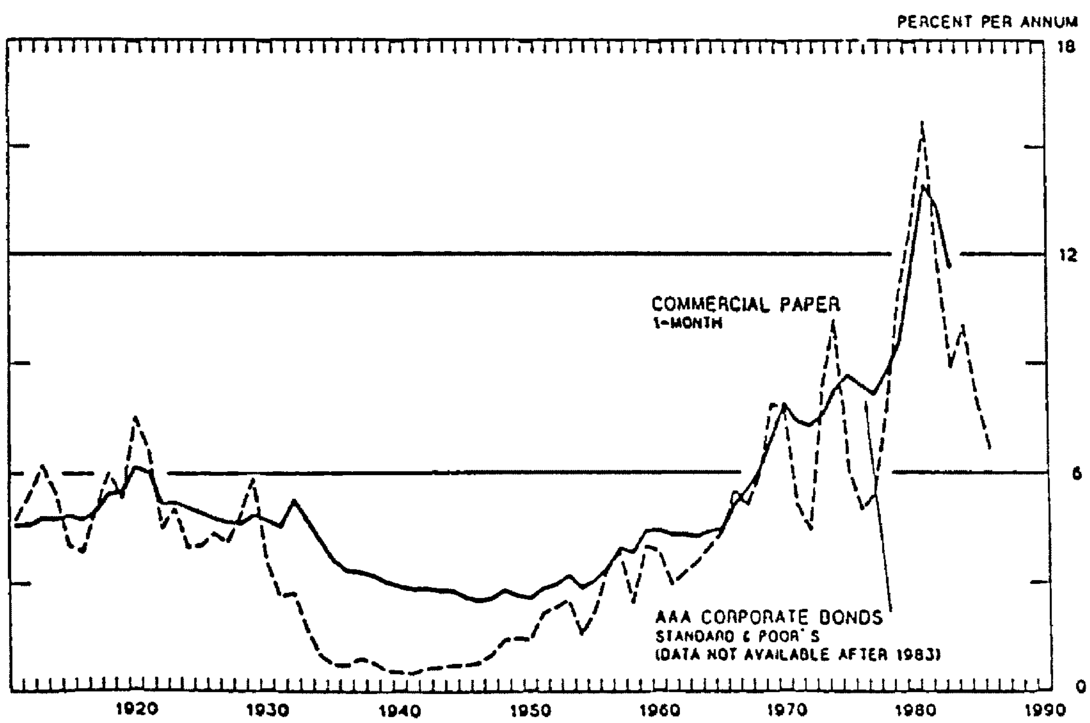
The biggest impact for the banking customer took six years to implement; the phase out of Regulation Q ceilings on interest rates paid on deposits. In order to accomplish this task, the Congress established the Depository Institutions Deregulation Committee (DIDC).

The DIDC began by tieing time deposit interest rates to Treasury Securities. Prior to implementation the maximum rate was 7.75 percent while six month commercial paper was paying 13.5 percent. The security the deposit was tied to depended on the length of the deposit. The DIDC then began to remove ceilings on long term time deposits and working its way down to shorter and shorter time deposits.

By March, 1986, all that was left was the decontrol of passbook savings accounts. At the time, the ceiling was 5.5 percent. But as figure 3 shows, market interest rates were

Figure 3

MARKET INTEREST RATES



Source: 1987 Historical Chartbook, (Washington, D.C., Board of Governors of the Federal Reserve System, 1987), p. 96.

low enough that when the ceilings were removed on April 1, most institutions did not raise rates.

As a single institution, the Federal Reserve was most affected by DIDMCA. Overall, the Federal Reserve gained more control over the economy. Not because it gained more reserves, in fact total reserves dropped slightly immediately following implementation, but because it gained wider and more discretionary power and more information.

While the dollar amount of reserves dropped, the number of institutions required to hold reserves rose from 5,500 to 40,000.[1] This, at a time when Federal Reserve policy was to control the economy through the manipulation of reserve requirements rather than through interest rates. This gave the Federal Reserve control over a wider spectrum of institutions.

The discretionary power to impose supplemental reserves was gained for use only if the economy were to spin wildly out of control. But, as with any market, the psychological impact helped.

The Federal Reserve also gained information because of DIDMCA. All institutions were required to report deposit information to the Federal Reserve. Institutions with deposits of $15 million or more began weekly reporting in October of 1980. Institutions with deposits between $2

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[1] "A Bill That Will Give The Fed More Power," Business Week, 2629, (Mar. 24, 1980), p. 49.

million and $15 million began monthly reporting in January, 1981. And institutions with deposits of $2 million or less began quarterly reporting in May, 1981.[2]

More information became available as non-member institutions had access to the discount window and Federal Reserve services. By monitoring these functions the Federal Reserve could glean more data.

In effect, the Federal Reserve lost a large amount of control over a relatively small number of banks, but gained small control over a large number of institutions while having information on those institutions' activities.

With the increased control came confusion. In the past, the Federal Reserve had defined M1, as all cash and transaction accounts. Money that account holders planned to spend. Savings that earned interest were included in M2, a lesser used tool. With the advent of automatic transfers, NOW accounts and share drafts the lines blurred between transaction accounts and savings accounts. How could the Federal Reserve distinguish between what moneys were going to flow into the economy and what moneys were to be held back as savings?

Eventually, interest bearing checking accounts were included in M1, but the Federal Reserve paid less attention to it in determining monetary policy. Its short term fluctuations had less significance as people kept savings in

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[2] Ibid., p. 68.

interest bearing checking accounts. This became more prevalent as market interest rates came down and the opportunity costs of doing so became less. Instead of paying strict attention to M1, the Federal Reserve set wider growth targets for it, while giving more attention to other money measures and interest rates than it had previously.

The ability of the Federal Reserve to invest in foreign government securities aided, though in a small way, the taxpayer of the United States. Prior to DIDMCA the Federal Reserve would place foreign exchange it bought in exchange operations in bank accounts in the nation to whom the currency belonged. In many cases it was illegal for those banks to pay interest on the deposits. By being able to invest in foreign government securities the Federal Reserve was able to earn a profit. When returned to dollar denominations, the profits were turned over to the Treasury. In 1982 this amounted to $32 million.[3]

The impact on other regulators were not so profound. The Comptroller and the FDIC were the least affected. As shown in table 3, banks remained financially strong overall and grew in number only moderately after 1981. Beyond streamlining regulations and changing reserve requirements, there was little change in rules covering bank practices. Bank failures did increase in the early 1980's, but this

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[3]Charles J. Partee, "Statement to Congress," Federal Reserve Bulletin, 69, (Mar. 1983), p. 193.

should be attributed to hard economic times and poor loans rather than to DIDMCA.

Table 3

INSURED BANKS, FINANCIAL CONDITIONS

Year	Number of Banks	Deposits (billions of dollars)	Equity/ Deposits (x 100)	Gvt. Aided Banks
1977	14,412	1,117	7.1	6
1978	14,391	1,234	7.1	7
1979	14,364	1,363	7.1	10
1980	14,435	1,481	7.3	10
1981	14,415	1,589	7.4	10
1982	14,452	1,707	7.6	42
1983	14,464	1,843	7.6	48
1984	14,481	1,963	7.9	79

Source: Statistical Abstract of the U.S., 1986, (Washington, D.C., U.S. Bureau of the Census, 1985), pp. 495-496.

The Federal Home Loan Bank Board (FHLBB) and the FSLIC did have more difficulties. Through DIDMCA, thrifts gained more leeway in how they could invest deposits. This made the regulator's job more difficult. New regulations had to be written to cover these areas and oversight became more complex. As with banks, savings and loan failures increased.

Different from banks, however, was the drop in equity as a percentage of deposits. The increase in investment authority lead to an increase in risky investments. Savings and loan failures far out paced bank failures drawing money from the FSLIC. This was especially true in the recession year of 1982.

Table 4

SAVINGS AND LOANS, FINANCIAL CONDITIONS

Year	Number of S&L's	Deposits (billions of dollars)	Equity/ Deposits (x 100)	Gvt. Aided S&L's
1977	4,761	387	6.3	na
1978	4,725	431	6.5	na
1979	4,684	470	6.7	na
1980	4,613	511	6.4	33
1981	3,292	525	5.4	79
1982	3,825	568	4.6	210
1983	3,502	635	5.3	54
1984	3,393	725	5.3	17

Sources: Statistical Abstract of the U.S., 1982-83, (Washington, D.C., U.S. Bureau of the Census, 1982), p. 509., Statistical Abstract of the U.S., 1986, (Washington, D.C., U.S. Bureau of the Census, 1985), p. 499., Statistical Abstract of the U.S., 1988 (Washington, D.C., U.S. Bureau of the Census, 1987), pp. 476-477.

No relationship between DIDMCA and the activities or policies of the Security Investors Protection Corporation or the Securities and Exchange Commission is discernable.

The number of banks was in decline prior to DIDMCA. Unable to pay high interest rates, big money was going to money market funds. From 1978 to 1979 money market fund assets quadrupled. State usury laws kept interest rates charged on loans below market rates. As inflation grew, it became increasingly unprofitable to be in the business of banking.

Table 5

COMMERCIAL BANKS, ASSETS
(figures in billions of dollars)

Year	1977	1978	1979	1980	1981	1982	1983
Commerc. & Indust. Loans	207	237	266	283	330	383	405
Commercial Mortgages	75	87	93	101	113	125	142
Residential Mortgages	102	125	144	154	163	167	177
Farm Mortgages	8	9	9	9	8	8	8
Institutional Loans	44	56	49	47	57	74	77
Security Loans	17	15	14	13	15	14	17
Farm Loans	26	28	31	32	33	36	39
Consumer Loans	142	168	188	182	187	193	218
Other Loans	18	20	21	22	27	34	42
All Loans	632	738	814	842	933	1033	1126
Less Write-offs	(22)	(26)	(29)	(30)	(31)	(32)	(33)
Net Loans	611	712	785	812	902	1002	1094
Government Securities	211	215	222	251	255	274	327
Other Securities	50	57	66	75	88	102	104
Total Securities	261	272	288	326	342	375	431
Cash & Equivalents	170	189	199	202	197	211	228
Other Assets	81	101	103	132	159	186	186
	====	====	====	====	====	====	====
Total Assets	1177	1329	1438	1544	1629	1878	2032
Number of Banks	14738	14741	14738	14704	14718	14763	14789

Source: Statistical Abstract of the U.S., 1985, (Washington, D.C., U.S. Bureau of the Census,1984), p. 494.

Note: Numbers may not add due to rounding.

With DIDMCA came relief. Though all banks were now required to hold reserves, they had the ability to charge market interest rates on their loans. They were able to offer more services, such as automatic transfers and NOW's, and able to pay higher interest rates. This enabled them to attract more deposits. With these reversals, the decline in the number of banks was also reversed. As shown in table 3 and 5, banking became profitable again.

Column five of table 3, shows that more banks failed after DIDMCA than before. As DIDMCA did not change the investment practices for banks it cannot be directly attributable for this increase. While having to pay more for deposits and holding reserves increased costs, the industry as a whole grew more profitable. It is more likely that the reason more banks failed was poor management. The industry became more competitive and those that could not compete dropped out.

Table 6

SAVINGS AND LOANS, ASSETS
(figures in billions of dollars)

Year	1977	1978	1979	1980	1981	1982	1983	1984
Mortgages	381	433	476	503	519	483	495	555
Cash & Equiv.	39	45	46	58	63	85	104	125
Other Assets	39	46	57	69	83	139	174	223
Total Assets	459	524	579	630	664	707	773	904
As % Yr. Prior		114	110	109	105	106	109	117
Total S&L's	4761	4725	4684	4613	4292	3825	3502	3393

Sources: Statistical Abstract of the U.S., 1982-83, (Washington, D.C., U.S. Bureau of the Census, 1982), p. 509., Statistical Abstract of the U.S. 1986, (Washington, D.C., U.S. Bureau of the Census, 1985),p. 498., Statistical Abstract of the U.S., 1988, (Washington, D.C., U.S. Bureau of the Census, 1987), p. 476.

The thrift industry needed DIDMCA in order to compete with banks and money markets in attracting deposits. Table 6 shows thrift assets increasing but at a slowing rate prior to DIDMCA. Asset growth picked up after DIDMCA.

However, DIDMCA was not enough. As shown in table 4, their deposits did increase, but this can be deceiving. The amount of increase from 1980 to 1981 was 2.5 percent. This is less than the interest the thrifts paid. Customers were withdrawing more money than they were depositing. It was clear that the DIDC was not moving fast enough. This lead to the Garn-St. Germain Depository Institutions Act of 1982.[4]

The number of thrifts helped by the FHLBB and the FSLIC is also deceiving. Though the assets of the thrift industry grew, the number of thrifts declined by more than their failure rate would indicate. Voluntary liquidations and mergers played a greater role than the FHLBB. Again, much of this can be attributed to increased investment powers during a recession and inflationary times. Saddled with low interest mortgages and the need to pay high interest rates, thrifts took more risks. When these risks resulted in losses, it forced consolidation. Even though the number of thrifts was declining prior to DIDMCA, the drop from 1980 to 1981 and beyond was more dramatic. The increase in non-mortgage investments corresponds with consolidation.

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[4]See Appendix for explanation of Garn-St. Germain Depository Institutions Act of 1982.

Thrifts were also disadvantaged by less experience. Transaction accounts and loose lending requirements were new to them as an industry. The learning curve became an added expense.

Taking the bank and thrift industry as one, the effects of DIDMCA can be seen in several areas. The lines of distinction between types of institutions became blurred. Prior to DIDMCA, thrifts could not offer demand accounts and were limited in their lending. Banks were forced to pay lower interest rates. After DIDMCA, all offered demand accounts, thrifts gained investment opportunities previously only open to banks and banks gained parity in interest paid.

This lead to greater competition between all institutions for a deposit base. Within the limits set by the DIDC, many different types of accounts were offered with varying maturities and varying interest rates and varying compound rates. Much of the money going into these new accounts came from passbook savings. So that at the same time institutions were fighting each other, they were losing a low cost source of funds and paying higher interest rates.

Competition was indeed fierce among depository institutions. As table 7 shows, the decline in the number of institutions continued after DIDMCA. Only banks managed to add to their total number after DIDMCA. Though all types of institutions had asset growth, credit union and savings bank growth was less strong. Competition with banks and

Table 7

DEPOSITORY INSTITUTIONS, NUMBERS AND ASSETS
(Assets in billions of dollars)

Year	Banks		S & L's		C.U.'s		S.B.'s	
	No.	Assets	No.	Assets	No.	Assets	No.	Assets
1977	14738	1177	4761	459	22330	54	467	147
1978	14741	1329	4725	524	22106	62	465	158
1979	14738	1438	4684	579	22012	66	463	158
1980	14704	1544	4613	630	21465	73	460	167
1981	14718	1627	4292	664	20697	72	454	185
1982	14763	1678	3825	707	19890	82	423	164
1983	14789	2032	3502	773	15877	82	534	261

Sources: Statistical Abstract of the U.S., 1982-83, (Washington, D.C., U.S. Bureau of the Census, 1982), pp. 505-510., Statistical Abstract of the U.S., 1985, (Washington, D.C., U.S. Bureau of the Census), 1984, pp. 494-507.

savings and loans is the most likely reason for this. With less resources, credit unions and savings banks were not able to compete in advertising and in the types of deals offered. Their charters also limited their areas of operation and the clientele they were able to recruit. As the industry moved more towards a selling approach, they were left behind.

Also, reserve and reporting requirements were hardest on the smaller institutions, especially those not members of the Federal Reserve. Having reserves meant less money to lend and, therefore, less earnings. The two page form used to report deposit balances was accompanied by 80 pages of instruction.[5]

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[5]William P. Bray, ABA Banking Journal, 72, (Dec., 1980), p. 74.

Even though interest rates paid by the banks and thrifts rose under the DIDC, money still left the industry. Interest rates were not rising fast enough to match money market rates. This was remedied by the Garn-St. Germain Depository Institutions Act of 1982. It was at that time brokerage firms took notice of the rising bank rates.

A 1970 amendment to the Bank Holding Company Act allowed nonfinancial institutions to begin banking type activities. These activities were limited to either taking deposits or making loans, but not both. Relaxed lending rules made such activities more lucrative. Also, distressed savings and loans and banks became an inexpensive way to enter the market.

Table 8

Non-Bank/Thrift Financial Assets
(figures in billions of dollars)

Year	1977	1978	1979	1980	1981	1982	1983	1984
Finance Cos.	133	158	185	199	226	236	260	294
Invest. Cos.	45	46	51	63	64	90	129	162
Sec. Dealers	28	28	29	36	39	43	49	61
Total	206	232	265	298	329	369	438	517

Source: Statistical Abstract of the U.S., 1986, (Washington, D.C., U.S. Bureau of the Census, 1985), p. 489.

Much literature was written at the time that this was the wave of the future, the facts do not bear this out. Table 8 shows DIDMCA had no affect on such operations. Non-bank/thrift assets grew no faster than bank or thrift assets.

Chapter III

The Markets

DIDMCA was destabilizing only for the most liquid markets - bank and thrift deposits. Those with large accounts at financial institutions moved their deposits to higher yielding time deposits and money markets. Initially small savers were left out of this market as the minimum certificate was $20,000 for short term certificates and $10,000 for long term certificates. The DIDC eventually lowered this to $1,000 and small savers gained better access.

Table 9, on the following page, shows that not only was money moving from low interest passbook deposits to high interest time deposits, but no-interest transaction and small passbook deposits moved to NOW type accounts where both interest and services were available.

These moves greatly increased the cost of money for the institutions. Profits were squeezed as competition grew. In an effort to deal with the situation, institutions offered many different products with varying maturities, interest rates and penalties. Within an institution, the products varied greatly due to the volatility of actual interest rates and institutional strategy varying between short term and long term.

Table 9

ACCOUNT TYPES AND DEPOSITS
(figures in billions of dollars)

Year	Checking	AT/Shares/ NOW's	Savings	Time	MMDA[a]	MMMF[b]
1977	240	5	487	599	-	4
1978	254	9	476	728	-	11
1979	264	17	417	872	-	44
1980	269	27	393	1014	-	76
1981	237	77	346	1129	-	189
1982	241	101	362	1185	43	234
1983	243	129	313	1119	376	179
1984	249	146	290	1302	417	230

Sources: "Financial and Business Statistics," Federal Reserve Bulletin, 68, (Jan.,1982) p. A13., "Financial and Business Statistics," Federal Reserve Bulletin, 71, (Jan., 1985), p. A13., "Financial and Business Statistics," Federal Reserve Bulletin, 73, (Jan., 1987), p. A13.

Notes: [a]Money Market Demand Accounts in banks and thrifts. [b]Money Market Mutual Funds held with brokerage houses.

Table 9 shows that the volume of personal and corporate money moving to money market mutual funds continued to grow in the early 1980's. It was a relatively safe place to put one's money because of liquidity and available transaction abilities. This growth was not stemmed until 1983 when the Garn-St. Germain Depository Institutions Act took effect.

Examining tables 5 and 6, it appears that DIDMCA had no effect on the loan market. It would have been interesting to see what the numbers would have been without DIDMCA. The cancellation of state usury laws made money available, albeit at higher interest rates, when it would have dried up in the high inflation of the early 1980's.

Although DIDMCA gave the thrifts further leeway in investing in corporate securities, the Act had no significant impact on either the bond or stock markets.

When the economy is viewed as a whole, the effect of the Act is unclear. Many other factors must be taken into account - new Federal Reserve policies, new Reagan Administration policies, the growth of European and Asian economies, to name a few. But some things can be inferred from table 10.

Table 10

GROWTH OF ECONOMIC INDICATORS
(Percent change over previous year)

	77	78	79	80	81	82	83	84
Req'd. Reserves	4	14	5	-8	3	0	-7	5
M-1, Money Supply	8	8	8	7	6	9	10	6
L, Money Supply	12	12	11	10	12	10	11	12
Gross Nat. Prod.*	12	13	12	9	12	4	8	9

Sources: Business Statistics, (Washington, D.C., Bureau of Economic Analysis, 1987), p. 63., Statistical Abstrat of the U.S., 1984 , (Washington, D.C., U.S. Bureau of the Census, 1983), pp. 449 & 500., Statistical Abstract of the U.S., (Washington, D.C., U.S. Bureau of the Census, 1987), pp. 407 & 463.

Note:*1987 dollars.

The negative growth of required reserves from 1980 to 1983 probably helped the economy as the Federal Reserve expanded its powers to all depository institutions and moved to stop high inflation. Low reserves combined with looser lending restrictions and deregulated interest rates to counter the Federal Reserve's tight monetary policies. In retrospect, DIDMCA was more important for what did not happen than what it caused. The recession of 1982 could have been much more devastating had DIDMCA not been enacted.

Chapter IV

THE INDIVIDUAL

As a whole, the American financial customer has benefited from DIDMCA. Today, even though the products are more standardized from institution to institution than in the early 1980's, there are more opportunities for the average bank account holder to earn interest on his deposits. NOW accounts and savings accounts are capable of paying market interest rates. And those accounts are insured for more money.

Lifting state usury laws have made the lending market more liquid. Prior to DIDMCA, when market interest rates rose above state ceilings, institutional lending dried up. Today, though one might have to pay higher rates in an inflationary environment, the money is available. Table 11, on the following page, shows a drop in consumer credit at banks and credit unions from 1979 to 1980 with no real recovery until 1982. Finance companies not hindered by the same regulations grew normally over the same period.

The smallest deposit customers suffered as a result of DIDMCA. Because institutions have to pay more to get deposits, they have looked to other means to generate

Table 11

CONSUMER DEBT OUTSTANDING
(millions of dollars)

	Comm. Banks	Finance Cos.	Credit Unions	Retail	Savings Inst.	Total
1977	112,374	37,973	37,605	23,490	9,265	223,669
1978	136,016	45,365	44,334	25,987	9,790	264,669
1979	154,177	56,607	46,517	28,119	11,164	300,313
1980	147,013	62,248	44,041	28,697	13,935	300,402
1981	147,622	70,070	45,954	31,348	16,547	315,944
1982	152,490	75,271	47,253	32,395	20,615	332,087
1983	171,978	83,310	53,471	37,582	29,222	379,694
1984	211,606	89,884	66,165	40,492	40,311	453,223

Source: Business Statistics, 1986, (Washington, D.C., Dept. of Commerce, 1987), p. 66.

revenues. This indicates that services were no longer a cost of doing business. Service costs were passed on to the customer. Minimum deposits are required in order to prevent check writing charges. Penalties for "bouncing" a check have increased. For some small depositors, it may actually cost money to maintain a checking account. (Charges and deposit size vary depending on the institution.)

All investors have gained a wider variety of areas to park their cash as a result of DIDMCA. Interest bearing checking accounts and various time deposit instruments give high yielding options.

Chapter V

CONCLUSIONS AND RECOMMENDATIONS

Hailed as the greatest banking measure since the 1930's, the Depository Institutions Deregulation and Monetary Control Act of 1980 fell short of its intended far-reaching impact. Congress directed a committee to deregulate interest rates paid by depository institutions over a five year period. At the end of this period, market interest rates were equivalent to previous regulated rates.

DIDMCA abolished state usury ceilings. This, at least made money available to those willing to borrow at high rates. But, it also assumes that institutions were willing to make risky loans in an uncertain environment. With few willing to borrow and few willing to lend, there was not an appreciable effect on lending markets.

Among those willing to lend were thrifts. They were saddled with low interest mortgages. In an effort to offset this low income and pay higher interest rates, thrifts made high interest, but high risk, investments. Only a small percentage of these type investments were allowed prior to DIDMCA. This, coupled with the further investment powers granted under a 1982 banking act and mismanagement, has lead to the current instability in the thrift industry.

This instability was driven by competition with banks. From a customer's point of view, the differences between banks and thrifts were greatly blurred. Each offered the same depository vehicles. Each competed for the same deposit base. But thrifts were unable to match bank earnings without high risk.

One area DIDMCA did have great effect was in Federal Reserve operations. The Federal Reserve was given opportunities to invest foreign reserves and was made to charge for services. This service charge forced it to compete with private service companies and so become more efficient.

As it provided more services, it gained more information. But this information only supplemented its best new information source. All depository institutions were required to report their deposits to the Federal Reserve.

The Federal Reserve gained the power to apply reserve requirements on all institutions. It gained more leeway in adjusting reserve requirements. Though the number of institutions holding reserves dropped, the Federal Reserve gained control over all institutions and so the economic incentive to leave the Federal Reserve System was lost.

The increased information and power gave the Federal Reserve much more control over the economy.

This study reveals that further research into DIDMCA's effects on U.S. government operations may be valuable. Three areas, in particular, are of interest: (1) How did the ability of the Federal Reserve to make a profit in foreign reserve operations effect those operations? (2) Were FOMC operations greatly altered as a result of more information and power? (3) Did simplification of banking regulations change the performance and abilities of regulators?

Another area deserves further study. The Garn-St. Germain Depository Institutions Act of 1982 has been mentioned throughout this paper. It would be informative to gage the effects of its enactment and how well those effects meshed with Congressional intent.

Appendix

THE GARN - ST. GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982

The Garn-St. Germain Depository Institutions Act of 1982 extended the policies of DIDMCA and forced the DIDC to take action on some accounts earlier than planned.

The 1982 Act gave thrifts even wider investment power than allowed under DIDMCA. This was needed because thrifts were having problems meeting the interest payments on deposits. The wider powers were needed so that higher yields could be obtained to offset low return mortgages.

In an effort to be fair with banks, the Act abolished the one quarter percent interest rate differential between banks and thrifts. Prior to the Act, banks were forced to pay one quarter percent less than thrifts on all deposits.

The Act also directed the DIDC to establish money market deposit accounts. Designed to pull money back from brokerage firms, these accounts paid market interest rates and had transaction capabilities. It was not until the passage of this Act that the securities industry took notice of rising interest rates at depository institutions. The Investment Company Institute filed suit on the grounds that because these accounts would be federally insured, they presented an unfair advantage. The Investment Company Institute lost the suit because it was clear brokerage houses had an unfair advantage at the time.

Time was given in order that regulators could adjust, but the provisions of the Act were to take effect no later than Jan. 1, 1983. As stated earlier, except for increased thrift investment powers, it only sped up what DIDMCA would have eventually done.

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